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March 8, 1995

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VIA HAND DELIVERY

Mr. William F. Caton
Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

DOCKET FILE COPY ORIGINAL

Re: Ex Parte Presentation in MM Docket 92-266

Dear Mr. Caton:

Pursuant to 47 C.F.R. § 1.1206, United Broadcasting Corporation ("UBC"), through undersigned counsel, submits this original and one copy of a letter disclosing a written and oral ex parte presentation in the above-captioned proceeding.

On March 8, 1995, the undersigned and Tillman L. Lay met on behalf of UBC with Kathy Franco, Nancy Stevenson, Edward C. Gallick, and Jonathan Ogur of the Cable Services Bureau. The meeting dealt with the maximum permissible rates for commercial leased access channels, including matters set forth in the attached written presentation of UBC. Copies of the attached written presentation were given to the FCC attendees at the meeting on March 8, 1995.

Very truly yours,

MILLER, CANFIELD, PADDOCK AND STONE

By Matthew C. Ames
Matthew C. Ames

Enclosure
cc: Kathy Franco, Esq.
Ms. Nancy Stevenson
Mr. Edward C. Gallick
Mr. Jonathan Ogur

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March 8, 1995

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UNITED BROADCASTING CORPORATION

DEVELOPING MAXIMUM PERMISSIBLE LEASED ACCESS CHANNEL RATES FOR ADVERTISER-SUPPORTED TIER LEASED ACCESS PROGRAMMERS: BASING THE RATE ON HISTORY AND MARKETPLACE EVIDENCE UNENCUMBERED BY THE EXTRA-MARKET INFLUENCE OF THE IMPLICIT FEE FORMULA

1. Leased access programmers serve an important purpose under the Cable Act: They ensure that a cable operator does not exercise complete bottleneck editorial control over all multichannel video programming delivered to the home.

2. The uncertainty and potentially exorbitant rates stemming from cable operators' interpretation of the implicit fee formula are stifling leased access programmers' ability to invest in new programming and facilities, and are threatening leased access programmers' survival and their employees' jobs.

3. Further delay by the FCC in revising the implicit fee formula will place leased access programmers in a protracted, resource-intensive struggle with large MSOs before the FCC and the courts, a struggle that leased access programmers lack the resources to sustain.

4. Affordability to channel lessees must be the critical criterion in setting maximum permissible rates if leased access is to fulfill any of the objectives of Congress in amending 47 U.S.C. § 532.

   - Cable operators will treat the maximum permissible rate as the minimum rate.
   - Cable operators have no incentive to make leased access rates affordable; to the contrary, by making leased access rates unaffordable, operators can effectively relieve themselves of all leased access obligations. (By and large, that is precisely why there is little or no leased access today, and why Congress found it necessary to amend the leased access provisions in the 1992 Cable Act.) Thus, the FCC cannot rely on free market forces to induce operators to lower rates if there are no takers (or takers die out) at the maximum permissible rate.

5. The current implicit fee formula yields prohibitive, unaffordable rates for any advertiser-supported leased access programmer on the basic or expanded basic tier.

   - The formula improperly allows operators to double recover subscriber revenues from advertiser-supported leased access programmers on the basic and expanded basic tiers.

- The longstanding industry practice for advertiser-supported tier programmers -- a practice established by operators and programmers themselves and which leased access providers had no role in creating -- is that net compensation runs <u>from</u> the cable operator <u>to</u> the programmer. The <u>only</u> exception is the case of must-carry broadcasters, which generally receive no compensation, but also pay <u>no</u> compensation to the cable operator. (While home shopping channels generally pay compensation to cable operators in the form of a percentage of sales, they are not advertiser-supported channels and thus should be treated as a separate class of leased access programmers. Determining the "going rate" for home shopping channels should be a simple task.)
- Some cable operators argue that leased access rates established in a manner similar to the FCC's current formula are not prohibitive except for "poorly-financed" or "non-viable" programmers. This argument is flatly contradicted by marketplace evidence:

  (a) If, as some operators argue, "adequately financed" and "viable" programmers could afford to pay leased access rates comparable to those yielded by the FCC's current rules, then the obvious question becomes: Why have cable operators, as rational profit-maximizers, not been charging those rates to the traditional (and presumably "viable"), non-leased access programmers on the operators' advertiser-supported tiers?

(b) In fact, the answer is obvious: No advertiser-supported tier programmer -- not even the "well-financed" and "viable" ones -- could afford to pay leased access rates as calculated by operators under the current implicit fee formula.

(c) The history of arrangements between operators and the established advertiser-supported programmers proves the point. The original advertiser-supported programmers in the late 1970s and early 1980s tried to survive solely on advertising revenues (although they, unlike leased access programmers, paid <u>no</u> compensation to operators for carriage). Even with free carriage, however, the traditional cable programming networks found it difficult to survive on advertising revenue alone. Indeed, the affiliate fees that operators pay to the established programmers today arose in the 1980s <u>precisely</u> <u>because</u> even the established programmers found that they could <u>not</u> survive on advertising revenues alone, but needed another revenue stream from operators.

(d) Rough calculations from public sources also prove the point. According to the _1994 Television & Cable Factbook_, CNN (presumably a "well-financed" and "viable" programmer) had nearly 57 million subscribers and received 24-33 cents/month/subscriber in affiliate fee revenues from cable operators. Using the FCC's implicit fee formula, cable operators in the Dade County, Florida, area have been demanding that leased access programmers pay rates of about 50 cents/month/subscriber. If CNN had to pay those rates (and if, in the process of course, CNN lost its 24-33 cents/month/subscriber in affiliate revenue), CNN would suffer a net loss from its present position of over $500 million, or _half a billion dollars_, per year. (Over $300 million of this figure would represent what CNN would have to _pay_ operators under the implicit fee formula; the rest would be lost affiliate fee revenues.) Even a well-financed programmer like CNN could not possibly survive a $500 million/year shortfall from its present position. In fact, according to published reports, CNN's total revenue for the first half of 1992 was only about $260 million. That is less than the $300 million CNN would have to pay to obtain carriage at the operators' new leased access rates.

(e) That advertiser-supported programmers could not survive if they have to pay significant carriage fees is further underscored by review of Bell Atlantic's recently filed video-dialtone tariff. Bell Atlantic proposes a recurring charge of only 5 cents per home passed per month, and even that rate falls with longer-term carriage. Bell Atlantic's proposed low monthly recurring rate reflects its realization that programmers cannot survive with high monthly carriage rates. That should hardly be surprising since, as we have already noted, the entire history of the cable industry and cable programming loudly proclaims this fact.

6. While the issue of whether leased access is remunerative to the operator is certainly relevant, what is remunerative to the operator cannot be assessed in a vacuum; rather, it can only be assessed in the context of (1) what the operator itself has considered to be sufficiently remunerative in the

context of other channels of a similar class; and (2) the operator's costs. When those factors are considered in the context of advertiser-supported tier channels, it is clear that <u>any</u> monetary compensation by leased access programmers to operators, no matter how small (say zero to 5 cents/subscriber/month) would make leased access channels substantially <u>more</u> remunerative to the operator than any other advertiser-supported tier programmer.

- Since the operator pays an affiliate fee to every other advertiser-supported tier programmer, <u>any</u> net payment to the operator by a leased access programmer necessarily makes the operator's margin on the leased access channel <u>greater</u> than the margin it earns on any other non-leased access advertiser-supported channel on the tier.
- Moreover, in the case of an operator subject to rate regulation (on either the basic or expanded basic tier), the operator's maximum permitted rate is based on the number of channels on the tier. As a result, carrying a leased access channel entitles the operator to charge a higher subscriber rate, even though, unlike all other channels on the tier, the operator pays nothing to the programmer. If the operator is allowed to charge the leased access programmer as little as a

penny or a nickel/subscriber/month for the channel, the leased access channel becomes a "win-win" situation for the operator: The operator is entitled to charge a higher rate to subscribers for carrying the channel while simultaneously earning revenue from the leased access programmer, a double revenue stream that no other non-leased access advertiser-supported programmer provides to the operator.

- Cable operators have provided little in the way of data about the out-of-pocket costs they incur for leased access. What evidence there is suggests that the incremental cost must be negligible. The Center for Media Education and the Consumer Federation of America have submitted evidence to the Commission suggesting that the annual incremental costs to a cable operator for a full-time leased access channel is only $783.
- UBC's Dade County experience confirms that little or no compensation is necessary to make leased access channels remunerative for operators. Until operators began revising (and dramatically escalating) their leased access rates based on their interpretation of the FCC's implicit fee formula, UBC paid leased access rates ranging from zero (with advertising compensation that the operators never exercised) to $5000 per month.

Given that these were rates voluntarily charged by operators in a pre-1992 Cable Act environment more hostile to leased access, these rates surely must have been remunerative and, given cable operators' market power, most likely excessively remunerative.

7. Operators' other arguments are nothing more than an attack on having any leased access at all.

- Some operators have complained that cable operators "will have to remove existing programming to accommodate channel lessees," thereby causing "subscriber disruption." This is really nothing more than an argument that operators should have no leased access obligations at all.
- Some operators have said that "reduced leased access rates" are unnecessary for "program diversity" because there are already "over 70 cable networks" and "a variety of highly diverse local programming ventures." This position reflects a fundamental misunderstanding of the diversity principle underlying leased access. Absent leased access, all programming carried on the system is filtered through a single gatekeeper: the cable operator. Regardless of the number or subjective variety of the programming a cable operator chooses to carry, there can be no true diversity as long as there

is a single gatekeeper making all programming decisions. The Supreme Court recognized as much in its recent Turner decision.

- Some operators claim that low leased access rates would "subsidize" supposedly "unsuccessful" leased programmers and thereby exclude new, supposedly "more talented and ambitious," non-leased access programmers (chosen, of course, by the cable operator). These same operators point out, however, that "it takes years to build a successful programming business, and programmers may not realize a profit for years." That may be true, but it proves the fallacy of the operators' argument: If it takes time for a programmer to develop even when it is unencumbered by leased access charges, how can operators seriously maintain that leased access programmers are unsuccessful when leased access programmers like TeleMiami have managed to survive subject to handicaps never faced by these new, supposedly "more talented and ambitious," programmers?

8. We understand that the Commission may be considering various ways of revising its current rules to promote the growth of leased access. We applaud the Commission's realization that

the current rules need to be changed, and certain aspects of the FCC's proposals that we have heard about may have merit. We caution, however, that no reform will succeed unless the implicit fee formula itself is revised to result in substantially lower maximum permitted rates.

- For example, one proposal that we are aware of would require operators to lease all of their available leased access channels by a certain date each year. An operator that failed to lease all of its channels would have to rebate an amount equal to the fee it would have received for the unleased channels to those leased access operators that did lease a channel. This proposal, however, does nothing to amend the current implicit fee formula, and raises at least four issues. First, how would the lease deadline be enforced? Without some enforcement mechanism, an operator would face no penalty for refusing to let any leased access operators on its system, and in fact would be penalized for doing so. In other words, if a system were currently carrying no leased access programming, what incentive would it have for adding any? There would be no party to whom to make a rebate. Second, the proposal does nothing to address a basic problem facing leased access -- the implicit fee formula is prohibitively high for all but a handful of programmers. Unless the formula is revised, operators will be able to keep leased access off their systems simply by demanding the maximum rate permitted by the implicit fee formula. Third, the proposal overlooks Section 612(i), which allows an operator to count certain minority and educational programming toward its leased access obligation even if the programming is not truly leased access. Operators could -- and undoubtedly would -- minimize their rebate obligations by carrying qualified minority and educational programming. The History Channel, which has been marketed to operators as a way of meeting their leased access obligations, is a good example. The result would be fewer leased access channels and exorbitant rates with little or no rebates. Fourth, the rebate approach could result in wide gyrations in leased access rates from year-to-year, depending on the number of leased access programmers on the system in a given year. Even established programmers, much less small leased access programmers, could not tolerate such unpredictability in a major cost of doing business.

- Another proposal would base the implicit fee not on the least-favored nonaffiliated programmer on a system, as the current rules do, but on the most-favored such programmer. While this approach would lead to lower rates, it is not clear that they would be reduced to affordable levels. Furthermore, the proposal still fails to avoid the double-recovery problem discussed above in paragraph 5. Operators are already earning revenue from subscribers for carrying leased access channels. The proposed "lowest implicit fee" formula would reduce the amount of additional, excess revenue an operator would receive for a channel, but not eliminate it.
- We also understand that a third proposal would establish a minimum rate, and then allow leased access programmers to bid to establish a maximum rate above the floor. In concept, this appears to us to be the best of the three proposals, but it begs the question of what the floor rate would be. Once again, the critical problem is that any floor approved by the Commission will immediately become the de facto minimum rate. If the floor is too high, there may well be no bidders at all. Even if there are bidders, the higher the floor, the fewer programmers will be able to meet

it (much less meet the maximum rate set by the bidding process). We repeat that because any rate paid by the leased access programmer to the operator constitutes double recovery, any floor must be kept very low. We would not, however, object to combining this proposal with the discussion in paragraphs 1-7 above, provided that, as long as an operator were carrying fewer channels than required by Section 612, there would be no bidding and the maximum rate would be the floor rate. Under such a scheme, a low floor would reduce the amount of double recovery and encourage a larger number of leased access entrants, and no leased access operator would be forced off the system, or to bid the rate higher, unless all the channels set aside for leased access were occupied. To make the proposal work, we suggest a floor rate of from zero to five cents per subscriber per month.

9. Finally, we note that any plan to increase leased access participation must take into account an additional problem. No matter what is done about setting maximum rates, operators will continue to be able to ignore their obligations by making the other terms of their proposed contracts with leased access programmers so unreasonable or

onerous as to discourage potential programmers from entering into them. Operators will simply take unreasonable stands on such things as the term of an agreement, the operator's termination rights, or the amount of a security deposit, and essentially refuse to negotiate. Such behavior might create the risk of being found to constitute bad faith, but only after a great many programmers have been deterred by the prospect of having to prove, at their own expense, the operator's lack of good faith.

CONCLUSIONS:

A. The Commission should reject operators' invitation to prolong the leased access rulemaking proceeding so that MSOs and established programmers can bury leased access programmers with mounds of filings. Because of the fragile financial status of leased access programmers, operators could accomplish indirectly through delay what the FCC has refused to allow them to do directly: destroy leased access programmers. While operators and established programmers complain that rate issues such as the "going forward" rules must be resolved quickly, they overlook that leased access programmers have been waiting ten years for relief from operators' raw exercise of market power over them.

B. The FCC's current implicit fee formula makes no sense in the context of advertiser-supported tier leased access programmers. Indeed, none of the established, well-known cable programmers could possibly survive if, rather than receiving license fees from operators, they were charged leased access rates based on the implicit fee formula.

C. If leased access is to survive at all, the maximum permissible leased access rate for advertiser-supported tier leased access programmers must be negligible. UBC suggests that the maximum permissible rate should be in the range of zero to 5 cents per subscriber per month.